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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 415

WALTER WANGER PICTURES, INC., a Corporation,

Petitioner,

vs.

ETHEL STRICKLAND ROGAN, as Executrix of the Estate of Nat Rogan, Deceased,

Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

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Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

To the Honorable the Supreme Court of the United States:

Walter Wanger Pictures, Inc., a corporation, prays that a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered in the above case on June 26, 1944, reversing a decision of the District Court of the United States, in and for the Southern District of California, Central Division.

Opinions Below.

The memorandum decision, as well as the findings of fact and conclusions of law and judgment of the United States District Court, Southern District of California, Central Division, are unreported but are contained in the transcript of record, pages 64 to 82, inclusive. The opinion of the Circuit Court of Appeals is as yet unreported but is set forth in the record, pages 189 to 194, inclusive.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on June 26, 1944. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. §347).

Statutes Involved.

Relevant statutory provisions are Section 14(a) and Section 26(c)(2) of the Revenue Act of 1936, c. 690, 49 Stat. 1648.

Sec. 14. Surtax on Undistributed Profits.

(a) Definitions.—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26(a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount allowed as a credit under Section 26(d).

(D) In the case of a national mortgage association created under Title III of the National

Housing Act, the amount allowed as a credit under section 26(e).

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26(c), relating to contracts restricting dividends.

* * * * * * * *

Sec. 26. Credits of Corporations.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * * * * *

(c) Contracts Restricting Payment of Dividends.—

* * * * * * * *

(2) Disposition of profits of taxable year.—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year for the discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

* * * * * * * *

Statement of Facts.

The action below is an appeal from the decision of the United States District Court, Southern District of California, Central Division, wherein judgment was entered on behalf of petitioner for the recovery of income tax for the years 1936 and 1937.

The petitoner reported a net income for 1936 of $92,-040.30 and paid the income tax due thereon of $21,546.86, and for the year 1937 reported a net income of $78,053.35 and paid the income tax due thereon of $24,386.60 [R. 68-70]. Thereafter petitioner was assessed and paid additional taxes for the year 1936 in the sum of $17,296.81 and respondent determined an overassessment for the year 1937 in the amount of $3,148.59. In the assessment of additional taxes for the year 1936 and in determining the overassessment for the year 1937, the respondent refused to allow to petitioner credits claimed by the latter under Section 26(c)(2) of the Revenue Act of 1936 [R. 71-73, 90, 92].

The District Court found that the petitioner was required to and actually did pay the sum of $82,522.57 in 1936 out of earnings of petitioner for the year 1936 to one of its debtors, in accordance with a written contract executed by petitioner prior to May 1, 1936, and that such amount so paid was not available for dividend payments in the year 1936, and pursuant to the provisions of Section 26(c)(2) of the Revenue Act of 1936 was entitled to a credit in the sum of $82,522.57. The District Court

also found petitioner paid, pursuant to the same written contract, during the year 1937, the sum of $12,186.10 out of earnings of petitioner for the year 1937 to its debtor, and this latter sum was also accordingly not available for dividends and should have also been allowed as a credit to petitoner [R. 73-74].

The District Court found the facts to be that on September 1, 1934, Jay Paley and Walter Wanger entered into an agreement in writing [attached to amended complaint as Exhibit "C", R. 17-33]; that after the execution of such agreement, they organized petitioner corporation which assumed their agreement, and pursuant thereto petitioner issued to Paley 3,500 shares of its preferred stock at $100.00 per share and 100 shares of its class "A" common stock for one dollar per share [R. 74-75].

Petitoner was organized for and did engage in the production of motion pictures, and after making and producing two motion pictures entitled "Private Worlds" and "The President Vanishes" Paley did, pursuant to the provisions of his contract of September 1, 1934, elect to withdraw from the corporation and made demand upon petitioner for the retirement of his stock in the amount of $350,000.00 and also for the repayment of $151,017.44 which he had loaned the petitioner. To comply with the demands made by Paley, an agreement was executed on March 18, 1935, between him and the petitioner which acknowledged the right of Paley to receive the sum of $501,017.44 [R. 36-37].

On March 18, 1935, the petitioner entered into a written assignment with the Bank of America National Trust and Savings Association, as trustee for Paley, whereby and wherein petitioner acknowledged its debt to Paley and did assign all its right, title, and interest in the two motion pictures entitled "Private Worlds" and "The President Vanishes" and all gross receipts received from the exhibition and distribution of said two pictures until Paley shall have been paid the full amount of his debt of $501,017.44 [R. 39-51].

The District Court found that under the written assignment of March 18, 1935, all earnings and profits derived from the release and distribution of the two pictures were paid to the bank in satisfaction of the debt due by petitioner to Paley and that such sums amounted to $82,522.57 for 1936 and $12,186.10 for 1937 [R. 76-77].

The District Court found that the sum of $82,522.57 paid by petitioner during the year 1936 to Paley and $12,186.10 paid by petitioner to Paley during the year 1937 represented earnings and profits of petitioner for said two years which petitioner was required by the provisions of the written contract executed on March 18, 1935, to pay within said years 1936 and 1937 in discharge of a debt [R. 77].

Decisions of District Court of the United States and United States Circuit Court of Appeals.

The District Court of the United States, Southern District of California, Central Division, rendered judgment on May 10, 1943, in favor of petitioner for $25,737.86, plus interest on the principal sum, being undistributed profits taxes for the years 1936 and 1937 [R. 81-82]. The District Court held and decided that petitioner did pay earnings and profits of both years 1936 and 1937 to a debtor and was entitled to credit therefor, pursuant to the provisions of Section 26(c)(2) of the Revenue Act of 1936, c. 690, 49 Stat. 1648 [R. 79-80]. The United States Circuit Court of Appeals for the Ninth Circuit reversed the decision aforesaid of the District Court.

Questions Presented.

1. Does the written assignment and subsequent payment of all proceeds derived from the distribution and release of two motion pictures expressly deal with the disposition of earnings and profits of the taxable year so as to entitle petitioner to a credit therefor in accordance with the provisions of Section 26(c)(2) of the Revenue Act of 1936?

2. Did the written assignment create a debt of the petitioner within the purview of Section 26(c)(2) of the Revenue Act of 1936?

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

(1) In deciding that the provisions of the written assignment failed to deal with and provide for the disposition of earnings and profits of the petitioner for the taxable years 1936 and 1937.

(2) In its failure to decide that the written assignment created a debt of petitioner within the meaning of Section 26(c)(2) of the Revenue Act of 1936.

(3) In reversing the decision of the United States District Court.

Reasons Relied on for the Allowance of the Writ.

1. The decision of the Circuit Court of Appeals herein is in conflict with the decisions of the Tax Court of the United States and the decision of the Circuit Court of Appeals for the Fifth Circuit in the case of *Scofield, Collector of Internal Revenue v. Valley Pipe Line Company*, 138 Fed. (2d) 835.

2. The Circuit Court of Appeals has decided an important question of Federal tax law which has not been but should be settled by this Court.

BRIEF IN SUPPORT OF PETITION.

1. The Decision of the Circuit Court Herein Is in Conflict With the Decisions of the Tax Court of the United States and the Decision of the Circuit Court of Appeals for the Fifth Circuit in Scofield, Collector of Internal Revenue v. Valley Pipe Line Company, 138 Fed. (2d) 835.

Section 14 of the Revenue Act of 1936, c. 690, 49 Stat. 1648, contained a provision for the levy of a surtax on the undistributed profits of a corporation. The term "undistributed net income" was further defined to mean such income less the credit provided in Section 26(c) relating to contracts restricting dividends. Subsections (c)(2) of Section 26 provides that where a written contract has been executed by the corporation prior to May 1, 1936 expressly dealing with and requiring the application of earnings and profits of the taxable year to be paid within the taxable year in discharge of a debt, that a payment pursuant to such a written contract will be allowed as a credit and serve to reduce the surtax on undistributed profits.

In the case of *Scofield, Collector of Internal Revenue v. Valley Pipe Line Company*, 138 Fed. (2d) 835, the taxpayer, in filing its income tax return for the year 1936, claimed an undistributed profits surtax credit of sums paid in the year under a contract restricting payments of dividends. The contract in question called for the payment on the 20th of each month of 75% of the gross income of the taxpayer for the preceding month toward the maturity

of its indebtedness. The Collector of Internal Revenue asked for a reversal of the District Court decision because the contract, instead of providing as to the required payments in the words of the Statute that the payments are to be made out of "the earnings and profits" of the taxable year, merely provides for payment out of the "gross income". The Collector urged that a provision for payment out of gross income is not the equivalent of a provision for the payment out of "earnings and profits" because payment out of "gross income" could be made even if there were no earnings and profits. The Court, in rejecting the contention of the Collector, stated at page 837:

> "As applied to this case, the argument is purely hypothesis. The facts undisputed and found here are that included in gross income for the year in question were earnings and profits considerably in excess of the credit allowed and that the parties in contracting understood that there would be. Realizing that this is so, the collector, citing in support Treasury Regulations 94, Art. 26-2(c), takes the flat position that unless the provision for payment is such that it cannot be satisfied except out of net income, it is insufficient and, though it was intended that they should be, the payments were in fact, made out of net income, since the provision did not designate this as the sole source, it is not effective as a basis for credit. We do not at all agree either that the regulation means what the collector claims that it does or that it would be valid if it did have that meaning. While it is true that it draws a distinction between 'net'

and 'gross' income, the regulation deals not with a provision, as here, for payment of a certain percentage of the gross income, but of an amount 'equal to' that percentage, and thus accords with the uniform current of authority. If it should be construed as having the effect of writing the word 'net' into the Statute before the words 'earnings' and 'profits,' it would amount not to a construction but to rewriting of the Statute, and this the Commissioner may not by regulation do. Gross income of necessity includes whatever earnings and profits there are. This view has been uniformly taken by the Board in cases cited below,[1] and all of these decisions have been acquiesced in by the Commissioner."

In the case at bar the Circuit Court of Appeals for the Ninth Circuit, after considering the decisions of the Tax Court of the United States, which were referred to and followed by the Circuit Court of Appeals for the Fifth Circuit in *Scofield v. Valley Pipe Line Company, supra,* expresses its disagreement and refused to follow the decisions of the Tax Court, even though most of the decisions had been acquiesced in by the Commissioner of Internal Revenue.

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[1]*G. B. R. Oil Corp. v. Commissioner,* 40 B. T. A. 738; *Joell Co. v. Commissioner,* 41 B. T. A. 825; *Brockway Glass Co. v. Commissioner,* 43 B. T. A. 267; *Baltimore Steam Packet Co. v. Commissioner,* 44 B. T. A. 629; *Helvering v. Northwest Steel Rolling Mills, Inc.,* 311 U. S. 46, 61 S. Ct. 109, 85 L. Ed. 29; *N. O. Nelson Co. v. Commissioner,* 45 B. T. A. 899; *Carolina-Florida Realty Co. v. Commissioner,* 46 B. T. A. 777, 778; *Paris & Mt. Pleasant R. Co. v. Commissioner,* 47 B. T. A. 439.

The Circuit Court of Appeals for the Ninth Circuit, in the case at bar, stated the following with respect to the decision of the Circuit Court of Appeals for the Fifth Circuit in *Scofield v. Valley Pipe Line Company, supra:*

> "That decision, page 837, makes the bald statement that to treat the term as net earnings and profits and not gross earnings and profits is not the Statute's 'construction but . . . a rewriting of the Statute, and this the Commissioner may not by regulation do.' For the reasons indicated we do not agree."

Petitioner respectfully submits that the decision and opinion below constitutes a direct conflict with the decision and opinion of the Circuit Court of Appeals for the Fifth Circuit which should be settled by this Court.

2. The Circuit Court of Appeals Has Decided an Important Question of Federal Tax Law Which Has Not Been but Should Be Settled by This Court.

This Court has taken occasion to consider the provisions of Section 26(c)(2) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, in the three cases of *Helvering v. Ohio Leather Company, Helvering v. Strong Manufacturing Company,* and *Helvering v. Warren Tool Company,* 317 U. S. 102. This Court has also considered the effect of a State Charter as constituting a contract restricting the payments of dividends in *Helvering v. Northwest Steel Rolling Mills, Inc.,* 311 U. S. 46.

The precise question here at issue concerning the meaning of the terms "earnings and profits of the taxable year", as used in Section 26(c)(2) of the Revenue Act of 1936, has never been considered by this Court, and the proper construction of the same is an important question of Federal law which has not been, but should be, settled by this Court.

Counsel for petitioner certifies that in their opinion this petition is well founded and is not interposed for delay.

It is respectfully submitted that this petition should be granted.

JOHN B. MILLIKEN,

L. A. LUCE,

Counsel for Petitioner.

August, 1944.

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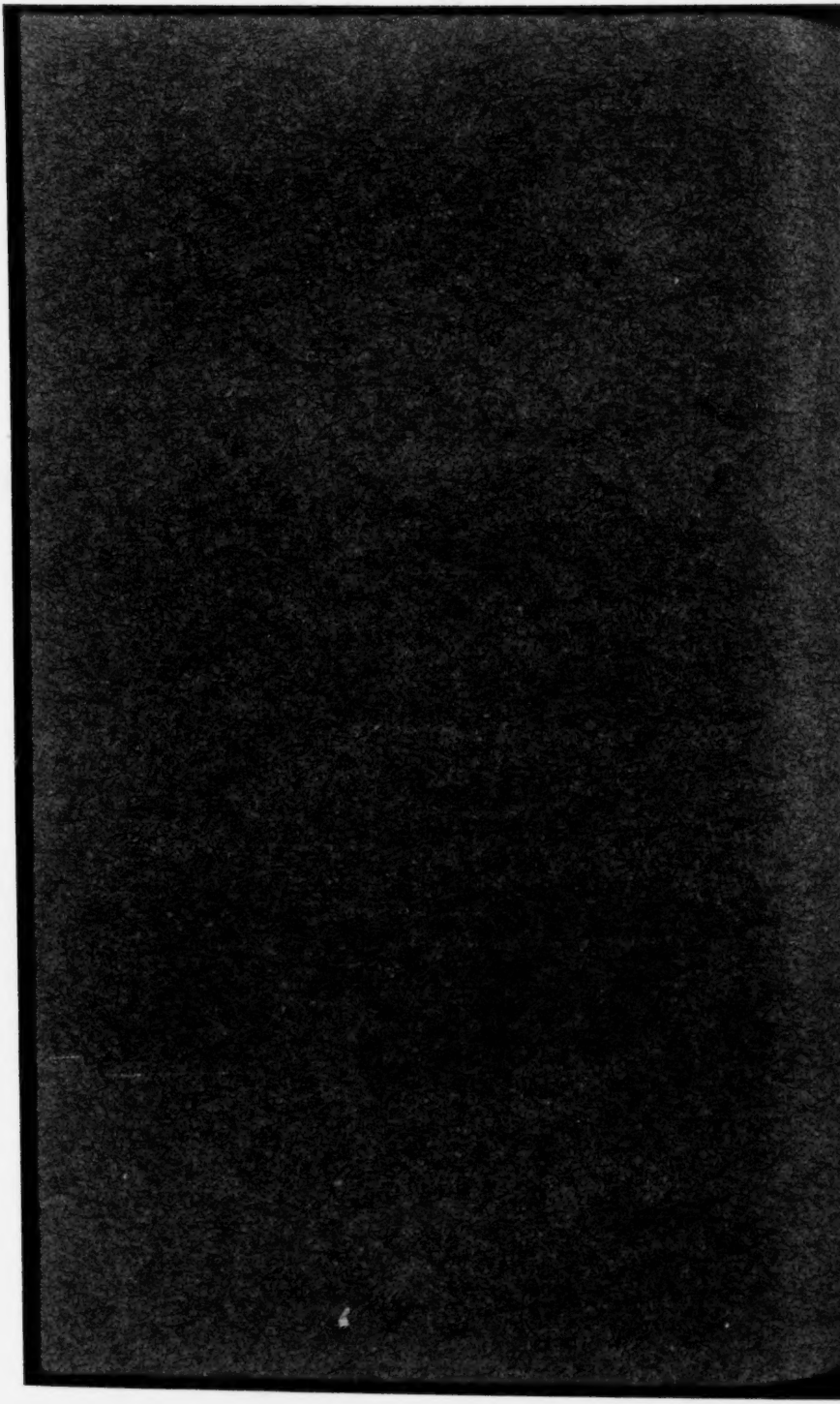
ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION



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OPINIONS BELOW

The memorandum opinion of the district court (R. 64–67) is unreported. The opinion of the circuit court of appeals (R. 189–194) is reported in 143 F. 2d 459.

JURISDICTION

The judgment of the circuit court of appeals was entered on June 26, 1944 (R. 195). The petition for a writ of certiorari was filed on August 30, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a contract provision, which requires taxpayer to apply the gross receipts from an earmarked part of its assets for the discharge of an obligation to a creditor, "expressly deals with the disposition of the earnings and profits of the taxable year" within the meaning of Section 26(c)(2) of the Revenue Act of 1936, entitling taxpayer to a credit thereunder.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The tax years concerned are 1936 and 1937. The Commissioner determined a deficiency in income taxes for the year 1936 in the amount of $17,296.81 and an overassessment for 1937 in the amount of $3,148.59. (R. 189.) In making both computations the Commissioner refused to allow credits asserted by taxpayer under Section 26 (c) (2) of the Revenue Act of 1936,[1] and its claims for refund based on the denial of such credits were rejected. The basis of taxpayer's contention was the payment in 1936 to Jay Paley, one of its debtors, of $82,522.57 and in 1937 of $12,186.10. (R. 189–190.) Taxpayer is in the business of producing motion-picture films. Paley had been one of its original organizers, its president and a stockholder, and

[1] Appendix, *infra*, pp. 12–13.

elected to disassociate himself from the corporation (R. 17–32, 39). Taxpayer had produced two pictures, entitled "The President Vanishes" and "Private Worlds." In March 1935 taxpayer made a written agreement with Paley (R. 36), acknowledging his—

> right to receive from the proceeds of "The President Vanishes" and "Private Worlds" the moneys which he had loaned to said corporation, to-wit, $151,017.44,[2] * * * and also the sum of $350,000.00 representing the amount to be paid for the redemption and retirement of the preferred stock issued to the Paleys, with interest thereon at the rate of five (5%) per cent per annum from October 13th, 1934.

To carry out these terms there was concurrently executed an assignment by taxpayer to a bank as trustee (R. 35), of (R. 41)[3]—

> all gross receipts which the undersigned corporation is and/or will be entitled to receive from Paramount Productions, Inc., derived from the distribution of those

---

[2] This sum had been advanced by Paley and used for the completion of these two pictures (R. 35, 39–40).

[3] In acknowledging this assignment, Paramount Productions, Inc., the distributor, consented (R. 50–51) "to pay to the Bank, its successors and assigns, and until the amount of indebtedness in said instrument referred to shall have been paid in full, all money, revenue, income, compensation and profits in connection with said two photoplays, which would otherwise be payable to said Walter Wanger Productions, Inc., out of said two photoplays, * * *."

> two certain photoplays entitled, "The President Vanishes", and "Private Worlds", * * *.

Paley agreed to look solely to the proceeds from these two photoplays for payment (R. 37). The agreement with Paley recites that taxpayer had undertaken to produce additional photoplays to be distributed by Paramount Productions, Inc., "now being made by it" (R. 36), under which taxpayer was also entitled to certain receipts (R. 36–37).[4] All the gross receipts of taxpayer derived from the release of these two pictures were paid to the bank for Paley, amounting in 1936 and 1937 to the sums already stated (R. 189).

The district court held in favor of taxpayer in an action brought for refund of the taxes paid, as a consequence of the denial of the claimed credit (R. 80). On the Government's appeal, the circuit court of appeals held that the refund should not have been allowed, and reversed (R. 194).

ARGUMENT

We submit that the decision below is correct, that there is no conflict with the decision of another circuit court of appeals on the same matter, and that no question of importance for the future administration of the tax laws is raised which should be settled by this Court.

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[4] The record further indicates receipts in February 1936, of profits earned to December 28, 1935, on other photoplays (R. 115–116), as well as other sources of income possessed by taxpayer.

1. The contract provision, which merely required taxpayer to apply the gross receipts from an earmarked part of its assets for the discharge of the obligation to Paley, does not "expressly" deal "with the disposition of the earnings and profits of the taxable year" within the meaning of Section 26 (c) (2) of the Revenue Act of 1936,[5] and taxpayer is clearly not entitled to a credit thereunder. Repeatedly it has been held, in accordance with the ruling of the court below (R. 191), that this section, since it grants a special deduction or exemption from a generally imposed surtax,[6] must be strictly construed (*Helvering* v. *Northwest Steel Mills,* 311 U. S. 46, 49; *Nevada-Massachusetts Co.* v. *Commissioner,* 128 F. 2d 347, 348 (C. C. A. 9th); *Commissioner* v. *Oswego Falls Corp.,* 137 F. 2d 173 (C. C. A. 2d)); and since it is a special credit in the nature of a deduction, taxpayer must sustain the burden of showing compliance with its exact terms. (*Helvering* v. *Ohio Leather Co.,* 317 U. S. 102, 106; *White* v. *United States,* 305 U. S. 281, 292; *New Colonial Ice Co.* v. *Helvering,* 292 U. S. 435, 440; *Buffalo Slag Co.* v. *Commissioner,* 131 F. 2d 625, 626 (C. C. A. 2d)). Thus, taxpayer is not entitled to a credit under this statute by a showing that its contract requires payments to be made out of net proceeds from a particular source and

[5] Appendix, *infra*, pp. 12–13.

[6] Revenue Act of 1936, Sec. 14, Surtax On Undistributed Profits, Appendix, *infra*, p. 12.

also other moneys (*Nevada-Massachusetts Co.* v. *Commissioner, supra*), and contracts requiring payments of stated amounts, or of amounts measured by the number of units of a commodity sold or produced, or of amounts measured by a percentage of bonds outstanding, do not expressly deal with the disposition of earnings and profits of the taxable year. (*C. C. Clark, Inc.* v. *United States,* 126 F. 2d 292 (C. C. A. 5th); *Helvering* v. *Moloney Electric Co.,* 120 F. 2d 617 (C. C. A. 8th), certiorari denied, 314 U. S. 682; *Clover Splint Coal Co.* v. *Commissioner,* 130 F. 2d 52 (C. C. A. 3d), certiorari denied, 317 U. S. 685; *Helvering* v. *Magnus Beck Brewing Co.,* 132 F. 2d 379 (C. C. A. 2d), certiorari denied, 319 U. S. 749; *Commissioner* v. *Saginaw & Manistee L. Co.,* 133 F. 2d 755 (C. C. A. 7th)).

The contract relied on here, moreover, does not deal with earnings and profits of taxpayer at all, but only with the gross receipts from two specified pictures which are earmarked for the purpose of paying a particular obligation, to whose proceeds the creditor agrees solely to look for repayment. Indeed, as the court below held, with the burden of proof on taxpayer, it did not even establish that the specified two pictures actually produced any earnings and profits whatsoever in the two years in question, and there well may have been a loss[7] (R. 192). To meet the statu-

[7] The taxpayer agreed to pay the costs of production and was to receive all gross receipts (subject to the assignment

tory requirements, the contract must set forth expressly, that is, in unmistakable language, that it is dealing with a taxpayer's earnings and profits. Here, instead, it refers merely to the "proceeds" (R. 36) and to "gross receipts" (R. 41–42) of two particular assets belonging to a taxpayer. Dividends cannot be paid out of gross receipts which may, in fact, represent no profits at all, but loss. The title of subsection 26 (c) (2) shows that it refers to "Disposition of *profits* of taxable year." [Italics added.] Certainly the reasonable construction, in view of the purpose of the statute, of the term "earnings and profits" is that it means net "earnings and profits" of the corporation and not the gross receipts from an earmarked portion of its assets.

2. There is no conflict between the decision in this case and that of the Circuit Court of Appeals for the Fifth Circuit in *Scofield* v. *Valley Pipe Line Co.*, 138 F. 2d 835, although, as the court below observed, a "bald statement" contained in the opinion of the Fifth Circuit Court of Appeals is in disagreement with some of the reasoning of the court below (R. 194.) In the cited case, the obligation was to pay monthly 75 percent of the gross income of a pipe line, which was the taxpayer's "only source of income," and the actual

to Paley) above the distributor's share (R. 157–179). But the record shows that the amortization of the cost of production on these two pictures on December 31, 1935, had equalled the amount of proceeds paid over by the distributor or $469,939.32 (R. 123).

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credit allowed was limited to taxpayer's undistributed net income. 138 F. 2d at 836, n. 3. In substance, the court there found the contract to be as practically construed by the parties, and said (p. 837):

> Gross income of necessity includes whatever earnings and profits there are, and the facts of this case showing that the taxpayer did not pay the full 75 percent of gross income it had agreed to pay because it did not have that much earnings and profits available leaves in no doubt that the contract as drawn, as intended, and as executed, was a provision for the payment of earnings and profits within the statute.

Thus, premised on this construction of the contract, the court in the cited case deemed the Government's contention there—that the "payment out of 'gross income' could be made even if there were no earnings and profits"—to be "pure hypothesis" since (p. 837):

> The facts undisputed and found here are that included in gross income for the year in question were earnings and profits considerably in excess of the credit allowed, and that the parties in contracting understood that there would be.

The court thus indicated that its allowance there of the credit was due to the fact that the evidence showed specifically that the taxpayer's gross income included earnings and profits for the taxable

year in excess of the amount of the credit which was claimed, and that the parties, in contracting, understood that this would be true. Consequently, while it may seem that the court gave too liberal an interpretation to the contract there, it is evident that, even applying the test laid down in that case, the credit would not be allowed here. Unlike the cited case, taxpayer here has made no proof that the two pictures in question did produce any earnings and profits whatever; and, in the absence of such showing, we must assume that the gross receipts were from an enterprise conducted at no profit at all (R. 192). Thus, the facts in this case differ substantially from those in the *Scofield* case; they do not constitute decisions on the same matter, and despite the conclusory statement contained in the *Scofield* opinion, the respective decisions do not result in a conflict of circuits.

In its opinion, the court below refers to a number of decisions of the Board of Tax Appeals (R. 194), which taxpayer had cited and which also had been cited in the *Scofield* case.[8] All of these cases were decided before the decision of this Court in *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102, *supra;* they are all distinguishable on their

[8] *Scofield* v. *Valley Pipe Line Co.*, *supra*, p. 837, note 6. The statement in the opinion there that "all of these decisions have been acquiesced in by the commissioner" is not correct.

facts and they fail to give adequate consideration to the rule of strict construction there laid down. In fact, in reasoning generally they relied upon such cases as *Commissioner* v. *Strong Mfg. Co.*, 124 F. 2d 360 (C. C. A. 6th), which was reversed in connection with the *Ohio Leather Co.* case. Indeed, one of them, *N. O. Nelson Co.* v. *Commissioner,* 45 B. T. A. 899, has itself been reversed on this ground by the Eighth Circuit Court of Appeals in *Helvering* v. *N. O. Nelson Co.,* 133 F. 2d 846, 850, certiorari denied, 319 U. S. 765.

3. No question important to the administration of the federal tax law is here raised. The provisions of Section 26 (c) of the Revenue Act of 1936 dealing with "contracts restricting payment of dividends" first appeared in that statute and were not continued in the Revenue Act of 1938 or in any subsequent Act. Accordingly, they apply only to income earned during the two years 1936 and 1937. Hence the question here relates strictly to a statute which has now been repealed almost seven years. Settlement of the question by this Court is not requisite in the public interest, for it is most unlikely that another similar case will come before the courts.

CONCLUSION

For the reasons above given, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount allowed as a credit under section 26 (d).

(D) In the case of a national mortgage association created under Title III of the National Housing Act, the amount allowed as a credit under section 26 (e).

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

* * * * *

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) *Contracts Restricting Payment of Dividends.*—

* * * * *

(2) *Disposition of profits of taxable year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26-2. [As amended by T. D. 5263, 1943 Cum. Bull. 1003.] CREDIT IN CONNECTION WITH RESTRICTIONS ON PAYMENT OF DIVIDENDS.—

(a) The credit provided in section 26 (c) with respect to the restriction on the payment of dividends is not available under every contractual or statutory prohibition which might operate to restrict the payment of dividends, but only with respect to those provisions of a written contract, a law, or an order of a public regulatory body, as the case may be, which satisfies the conditions prescribed in the Act. The charter of a corporation does not constitute

a written contract executed by the corporation within the meaning of section 26 (c). The restrictive provisions recognized by the Act are of three general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year;

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings and profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936;

* * * * *

(c) *Disposition of profits of taxable year.*—Under the provisions of section 26 (c) (2), a corporation is allowed a credit in an amount equal to that portion of the earnings and profits of the taxable year which, by the terms of a written contract executed by the corporation prior to May 1, 1936, and expressly dealing with the disposition of the earnings and profits of the taxable year, it is required within the taxable year to pay in, or irrevocably to set aside for, the discharge of a debt incurred on or before April 30, 1936. The credit is limited to that amount which is actually so paid or irrevocably set aside during the taxable year pursuant to the requirements of such a contract.

Only a contractual provision which expressly deals with the disposition of the earnings and profits of the taxable year shall be recognized as a basis for the credit provided in section 26 (c) (2). A corporation having outstanding bonds is not en-

titled to a credit under a provision merely requiring it, for example, (1) to retire annually a certain percentage or amount of such bonds, (2) to maintain a sinking fund sufficient to retire all or a certain percentage of such bonds by maturity, (3) to pay into a sinking fund for the retirement of such bonds a specified amount per thousand feet of timber cut or per ton of coal mined, or (4) to pay into a sinking fund for the retirement of such bonds an amount equal to a certain percentage of gross sales or gross income. Such provisions do not expressly deal with the disposition of earnings and profits of the taxable year. A contractual provision, however, shall not be considered as not expressly dealing with the disposition of earnings and profits of the taxable year merely because it deals with such earnings and profits in terms of "net income," "net earnings," or "net profits."

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